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NEWS ANALYSIS

By Ron Grover

More Trouble in the Mouse House

As *Treasure Planet* heads for a black hole, the SEC is said to be asking why Disney delayed listing board members with kin on the payroll

You can add an inquiry by the Securities & Exchange Commission to Walt Disney's list of recent woes. The entertainment giant, already suffering from a lackluster stock price, a slowdown at its theme parks, and a misfiring animated film, now has the feds looking over its shoulder as well. On Dec. 3, Disney said it was cooperating with "a nonaccounting-related inquiry" in connection with the August filing of additional information on its fiscal 2001 financials.

In that required 10-K filing, Disney ([DIS](#)) acknowledged that four of its independent directors had relatives working with the company or at a Disney-owned affiliate. The issue in the inquiry, according to someone with knowledge of the matter, centers on whether Disney may have delayed informing the SEC. Disney declined to comment on the investigation or to make any board members available. The SEC didn't return phone calls seeking comment.

The relatives employed included Louise Bryson, who last year earned \$1.35 million as an executive vice-president of cable channel Lifetime Entertainment Television, of which Disney owns 50%. She's the wife of board member John Bryson, who's CEO of utility giant Edison International ([EIX](#)). Disney also reported in August that board member Reveta Bower's adult son had worked until recently at Disney's Internet unit, earning \$81,863, and that board member Ray Watson's adult son, David, last year earned \$152,608 as an executive with Disney Channel.

GOLD STANDARD. The most interesting of the August revelations was that the adult daughter of board member Stanley Gold was also a Disney employee, earning \$85,111 last year as an executive of the its consumer-products unit. Gold has been Disney Chairman Michael Eisner's harshest board critic, and the August disclosure sparked speculation that Eisner would attempt to blunt Gold's criticism by questioning whether he was eligible to serve as independent board member.

Only independent board members can sit on the two main committees, audit and governance, the latter being chaired by Gold at the time. Citing different circumstances -- that Gold had a "significant business relationship" with company Co-Chairman Roy Disney -- Disney's board determined that Gold no longer qualified as an independent director. Bryson has been tapped to take over the governance committee.

That move, and others aimed at making Disney's board more independent, still didn't push the stock out of harm's way. What weighed more heavily was the surprise announcement on Dec. 3 that Disney was reducing earnings by \$47 million for its fourth quarter, ended Sept. 30, due to the

lower-than-expected performance of big-budget animated film *Treasure Planet*.

OLD STRATEGY. Produced for an estimated \$140 million, the movie sold only \$16.6 million worth of tickets when released over the Thanksgiving weekend. Under complex accounting rules, Disney says an adjustment is required to the film's book value for the fourth quarter, because the movie opened in theaters after the quarter had ended but before the company filed its financial report with the SEC. Disney executives tried to soften the blow, telling analysts that the futuristic pirate film was produced under a prior business strategy, and that it has since slashed the average cost of making animated films.

Still, the stock market took it out on Disney by slicing nearly 5% off the share price on Dec. 4, when it closed at \$17.68. Until then, fueled by a modest turnaround at Disney's ABC network and better-than-anticipated theme-park attendance, the stock had followed a mostly upward path, having risen by nearly 26% in the last two months, to \$18.54.

Analysts said the disclosure of the SEC inquiry was likely not material to Disney's prospects. "We believe the SEC inquiry to be largely a nonissue, as it is not related to accounting in any way," wrote CIBC analyst Michael Gallant, who rates Disney a sector performer, CIBC's second-highest rating. "It was disclosed [in August] that Disney's independent board members had ties to Disney," said JP Morgan analyst Spencer Wang in a report. "As a result, we do not view this as 'new' news."

TOO COZY? Nevertheless, the independence of Disney's board continues to be an issue. In what was a busy day of announcements, Disney also said on Dec. 3 that it was continuing with a an effort under way for almost a year to overhaul its board, which has been criticized for being too cozy with Eisner. The board redefined two members -- Gold and architect Robert A.M. Stern -- who had been listed as independent. (Stern is designing Eisner's beach house.)

To increase the number of independent board members, who now number 12 of 17, the board elected former Seagram CFO Robert Matschullat and said he would chair the audit committee. Former U.S. Senator George Mitchell, a current member, was elected to the new position of presiding director and charged with holding two meetings annually without Eisner or other executives present. Disney also said it was committed to reducing the number of board members to as few as 12 but gave no timetable for when that would happen.

An SEC inquiry unrelated to accounting is likely a less serious concern than if regulators were probing Disney's books. But as Eisner struggles to improve the company's image and get profit growth back on track, Disney hardly needs more hassles.

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